Don't Forget About the Military Lending Act

Until December 2017, the auto industry operated under the understanding that the federal Military Lending Act's (MLA) exclusion from coverage for credit transactions "expressly intended to finance the purchase of a motor vehicle when the credit is secured by the vehicle being purchased," extended to essentially all auto financing transactions. In other words, dealers thought that they didn't have to worry about complying with the MLA. However, the Department of Defense (DOD) turned that understanding upside down when it announced that financing "credit-related costs" mean that the transaction would be covered by the MLA.

According to the DOD, if a purchase-money transaction also finances "credit-related costs"—such as Guaranteed Auto Protection insurance and credit insurance premiums—then creditors must identify covered borrowers, provide required disclosures, calculate the Military Annual Percentage Rate of the transaction, and otherwise comply with the MLA's consumer protections. By contrast, if the transaction only finances "costs related to the object securing the credit"—such as leather seats, extended warranties, and even negative equity—then it is not covered by the MLA.

You may be thinking, "That's no problem—we'll just comply with the MLA." However, unfortunately, the issue is further complicated by the fact that the MLA prohibits using the title of a vehicle as security for a transaction with a covered borrower. This leaves dealers in a "catch 22." That is, transactions with covered borrowers that finance credit-related costs, like GAP or credit insurance, are covered by the MLA. But the MLA prohibits those transactions because they are secured with a vehicle title. So what can dealers do?

The most conservative approach is to stop selling GAP and other types of credit insurance products completely. Many in the auto finance industry have chosen to take this conservative approach because of the MLA's ban on arbitration provisions and its draconian penalties—nonconforming transactions are void from inception, and the MLA provides both criminal and civil penalties, attorney fees, along with a private right of action, which could be brought as a class action lawsuit.

If discontinuing the sale of GAP and other credit-related products and services isn't feasible, dealers could check the covered borrower status of every applicant, and not offer GAP or other credit-related products to covered borrowers. Creditors who take this approach should also take advantage of the MLA's safe harbor for covered borrower status determinations. However, this approach does present risk, as offering products and services only to certain consumers, but not to covered borrowers, could result in allegations of UDAAP, or could support claims that such practices violate the laws of states that prohibit discrimination on the basis of military status.

Finally, one last way to finance a credit-related cost in a purchase-money auto financing transaction entered into with a covered borrower and to comply with the MLA, is to not take a security interest in the vehicle being purchased. Understandably, this is a business risk that most dealers and finance companies are not willing to take.

Though many have anticipated that the DOD would withdraw its guidance regarding "credit-related costs" and the MLA's purchase money exclusion, it has not yet done so. Accordingly—at least for now—dealers must still wrestle with the DOD's interpretation, and decide how best to comply with the MLA in their auto deals.

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